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Federal Docket Management System Office
1160 Defense Pentagon
Washington, D.C. 20301-1160

Re: Limitations on Terms of Consumer Credit Extended to Service Members and Dependents (Public Law 109-364 Section 670)
DOD – 2006 – 0S – 0216, 71 Fed. Reg. 233 (December 5, 2006)

Ladies and Gentlemen:

HSBC North America Holdings Inc. ("HSBC North America")[1] appreciates the opportunity to comment on the implementation of the John Warner National Defense Authorization Act for Fiscal Year 2007, Pub. L. 109-364, Section 670, "Limitations on Terms of Consumer Credit Extended to Service Members and Dependents" (hereinafter, the "Act"). The Act imposes a new scheme of rate regulation and disclosures for consumer credit products offered to military personnel and their dependents. The Department of Defense (the "Department") is responsible for prescribing regulations to carry out the Act.

HSBC North America is a bank holding company that operates various bank and non-bank subsidiaries in the United States and Canada. Our largest bank subsidiary, HSBC Bank USA, N.A., Wilmington, Delaware, operates more than 400 branches, which are located in the states of New York, New Jersey, Florida, Pennsylvania, Massachusetts, California, Washington, Oregon, and the District of Columbia. HSBC North America also owns HSBC Finance Corporation, which issues consumer credit cards through HSBC Bank Nevada, N.A., Las Vegas, Nevada, and consumer loans under state licenses. Other subsidiaries of HSBC North America engage in a broad range of financial activities in the United States.

[1] HSBC North America is a wholly-owned subsidiary of HSBC Holdings plc ("HSBC Holdings"), and is the bank holding company through which HSBC Holdings conducts its operations in the United States and Canada. Together, HSBC Holdings and its subsidiaries are referred to herein as "HSBC Group."

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## I. General Comments

HSBC Group has an established track record of cooperation with the military services, evidenced in part by our commitment to the Servicemembers Civil Relief Act (50 U.S.C.A 501) ("SCRA"). We fully intend to continue to afford our military men and women and their families a fair and equitable source of credit, in keeping with the letter and the spirit of the Act. However, the nature of the Act's disclosure requirements, ambiguous terms, and severe penalties for violations may limit what products banks and other lenders will be able to provide to servicemembers and their dependents going forward. Thus, unless the implementation rules are clarified and carefully drawn, the Act may have the unintended effect of reducing the availability of a wide variety of credit products to individuals who are covered by its requirements. We are equally concerned about the potential effect of the new disclosure requirements, which will be layered onto an existing scheme of consumer credit regulation. The potential for confusion is significant, and we urge the Department to proceed in consultation with the Board of Governors of the Federal Reserve System (the "FRB") to help ensure that the overall disclosure framework provides servicemembers with the benefits Congress intended.

The question of what loans are covered by the Act is particularly significant. As detailed further below, the Act potentially affects a wide variety of products, including credit cards, automobile loans, home equity loans and lines of credit, retail installment sales contracts, and home improvement loans. To avoid unduly limiting the availability of these products, we would suggest that the definition of "consumer credit" be carefully drawn. Questions of applicability also arise due to the relationship of loan transactions to the effective date of the Act, which applies to extensions of consumer credit made on or after its effective date. This creates ambiguity particularly in two situations: (1) where a covered member obtains an open end account prior to the effective date of the Act and obtains an advance on the open end account after the effective date; and (2), where a person who is not a covered member obtains a loan or account after the effective date and thereafter becomes a covered member. In both cases, the disclosures, customer agreement, and any other terms will have been made consistent with the law at the time they were made. We would suggest that the regulations need to clarify what the rights and obligations of both borrowers and lenders will be in these cases. The question of who is covered by the Act is crucial as well. For example, lenders will need a practical, effective means to identify those who are no longer dependents covered by the Act, either because the primary servicemember is no longer in active duty or the rolling 180 day support element is no longer met.

## II. Section by Section Comments and Recommendations[2]

### *(a) Interest.*

This section states that a creditor shall not require a covered member or dependent to pay interest except as agreed to under the terms of the credit agreement or promissory note. Under existing law, because certain open end credit accounts, including credit card accounts, may be open for indefinite periods of time, lenders have the ability to change the terms, including the interest rate, provided that allowance for such changes in terms was included in the original credit agreement. This practice allows lenders to make adjustments to consider market forces, new features, and safety and soundness considerations. Because products like credit cards are issued in such high volume, changes to account terms must be made on a portfolio rather than on an individual basis. Thus, a prohibition on such changes would effectively require many lenders to close accounts which could not be subject to the change in terms. Rather than impose such a drastic restriction on credit, we would suggest that the regulations clarify that servicemembers have the option of continuing to use such an open end account under the new rates and/or other terms, rather than face termination of the account.

### *(b) Annual Percentage Rate*.

Section (b) prohibits a creditor from charging servicemembers or their dependents an annual percentage rate greater than 36%, inclusive of all fees and "ancillary products." To avoid unnecessarily eliminating certain financial products and services from the scope of what may be offered to servicemembers and their dependents, we urge the Department to narrowly define the terms "Creditor," "Consumer Credit," and "Interest" (these definitions are discussed further on pages 7-10, supra.). Examples of services potentially rendered unavailable to persons covered by the Act are described below.

- A credit card may have an interest rate significantly below 36% but, using the definition of annual percentage rate that appears in the Act, a relatively common cash advance fee of $10 may cause the annual percentage rate to exceed the 36% limit in any particular month depending on the size of the cash advance. Thus, if a cardholder who was a servicemember took such an advance, the amount owed on the credit card would be rendered uncollectible by the bank. Given such a risk, it may not be feasible for credit card issuing banks to offer cash advance products to service members.

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[2] Each section referenced is a section in 10 U.S.C.A. Section 987.

- At the time of application, creditors often provide borrowers the opportunity to purchase a number of ancillary products, including identity theft protection and credit report monitoring, and debt waiver or cancellation protection. Each of these program types is disclosed as optional and program enrollment does not impact credit decision. These programs are also made available to customers after their credit account has been approved and opened, which reinforces their optional nature. FRB staff have recognized that such optional programs, sold after the existence of a credit account, should not reasonably be considered as a cost of credit. Accordingly, the staff commentary to Regulation Z (226.4(b)(7)-(8)) states that "insurance sold after consummation in closed end credit transactions or after the opening of a plan in open end transaction is not 'written in connection with' the credit transaction if […] or because the consumer requests insurance after consummation or the opening of a plan." Thus, would encourage the Department to coordinate its rules with these provisions of Regulation Z. These products might have particular benefit for persons who expect to be away from their homes and this country for an extended period of time. However, by including their costs in the calculation of the annual percentage rate, the Act will effectively make them unavailable to persons who might need them most.

***(c) Mandatory Loan Disclosures***

Section (c) requires certain disclosures, including disclosures required under the Truth in Lending Act and its implementing regulation, "Regulation Z" (12 C.F.R. Part 226), to be provided orally "before the issuance of credit." Consistent with Regulation Z, Section (c) appears intended to protect covered members and their dependents from entering into credit transactions without knowing or understanding all of the terms or conditions of the transaction. As a practical matter, though, we are concerned that borrowers may not necessarily have a better understanding of the transaction simply because the creditor has orally recited the disclosures required by this section. Instead, this provision may render covered transactions more complicated and cumbersome for borrowers, and more costly and risky for creditors. Moreover, the requirements of an oral disclosure is certain to limit access to credit products routinely obtained by mail or through the internet. As a result, we suggest that the Department limit the application of oral disclosures to products not obtained by mail or through the internet. We would also suggest that any final rules clarify which disclosures must be provided orally and which in writing. For example, 12 C.F.R. §226.5(a) of Regulation Z requires the "Schumer Box" disclosures at time of application. Other, longer and more detailed disclosures required by 12 C.F.R. §226.6 must be delivered in writing "before first use of the credit account."

We also note the following:

- It takes approximately 5-8 minutes to fully read 12 C.F.R. §226.5(a) disclosures over the telephone, and it would take much longer for a creditor to read everything required by 12 C.F.R. §226.6, including detailed rate information (daily periodic rates), 12 C.F.R. §226.12(b) unauthorized use protections, 12 C.F.R. §226.12(c) claims or defenses against card issuer, and 12 C.F.R. §226.13 billing error resolutions (which are quite long and detailed).

- Certain forms of applications require no application disclosures at all under Regulation Z (for example, inbound phone applications responding to a general solicitation), and we would suggest that those applications be excluded from the oral disclosure requirement.

- Applications received through the mail and internet are increasing each year. One of our credit card businesses receives approximately 60% of its credit applications through the mail or the internet. Delaying such applications until the applicants could be contacted by telephone for the 10-15 minutes of oral disclosures would inconvenience customers and add cost to products without necessarily providing a countervailing benefit.

- Further complexity is added by the fact that Regulation B, 12 C.F.R. Part 202, requires lenders to provide a final credit decision within 30 days of application. Because a lender could fail to reach applicants by telephone during this period, the lender would be left with only the option of denying credit to comply with the Act.

- Section (c) is also ambiguous in that it requires a clear description of "the payment obligations" of the covered member or dependent. Generally speaking, the entire customer agreement documents the payment obligation, which in some cases is an 8-12 page document. We suggest that the regulation clarify, through model language, what is meant by a clear description of the payment obligation, and that it be limited to key terms of the credit agreement.

- Regulation Z also requires post-application disclosures, which would be impractical to provide orally. Examples include monthly statements and related disclosures under 12 C.F.R. § 226.9(a), change in account terms under 12 C.F.R. § 226.9(c), and card renewal disclosures under 12 C.F.R. § 226.9(e). We would suggest that these be excluded from the oral disclosure requirement.

- Under the Act, we presume that a lender would learn of someone's status as a "dependent" by using adequately detailed questions on a credit application. As a result, in the case of mail and internet applications, the creditor would not know until after an application has been received (presumably having provided all disclosures in compliance with applicable law) that the Act's disclosure requirements apply before an account can be opened. With respect to telephone applications, creditors will need similar information to establish whether enhanced telephone disclosures must be provided.

- We would also suggest that, as subsection (c)(1) applies to information provided covered members or dependents "before the issuance of credit", that the rule require that only those who are covered persons at time of application receive the disclosures. It would not be practical to re-disclose orally to everyone who becomes a covered person after the time of application.

- The disclosure requirements will also impact the processes of lenders who offer private label credit cards for a retail merchant. In such a case, it is often store employees who provide the written account opening disclosures to the applicant. The final rules will need to allow for a practical method for providing any required additional disclosures.

***(d) Preemption.***

No comment.

***(e) Limitations.***

Subsection (e)(1) would prohibit a covered member and dependent from, among other things, renewing or refinancing an existing loan with the same lender. However, we would suggest that many circumstances exist where renewing or refinancing with the same lender is clearly appropriate. This provision, for example, could work to the detriment of a borrower seeking to refinance loans to reduce their interest rate, or even to enter a workout agreement in lieu of a foreclosure or repossession. A potential way to avoid this anomalous result would be to limit the definition of "consumer credit," as discussed further on pages 7-10, supra.

Subsection (e)(5) states that it is unlawful for a creditor to extend credit where a "creditor uses a check or other method of access" to an account maintained by the borrower. We would strongly encourage the Department to clarify that this provision does not (1) prohibit acceptance of checks for payment of loans, or (2) prohibit borrowers for enrolling in direct debit payment programs for loans that otherwise comply with the Act and applicable law. We note in particular the benefits of direct debit, which significantly reduces the chances of incurring delinquency fees and negative reporting to credit bureaus resulting from late payments. Further, we note that this section could remove deposit accounts from a borrower's assets available to secure loans. For individuals with blemished credit, a secured credit card is often the first step they can take to rebuild their credit rating and graduate to more traditional loan products. Secured credit cards would no longer be available to members of the armed forces or their dependents unless the definition of consumer credit is limited, or the applicability of this section is otherwise limited.

Subsection (e)(5) also prohibits the extension of consumer credit to covered members and their dependents if the creditor "uses" the title of a vehicle as security for the obligation. Presumably, this section was intended to protect servicemembers and their families from the high interest rates and other abuses commonly associated with "title loans". However the broad language of the statute presents a possibility of limiting the availability of standard auto loans to servicemembers and their families in so-called "title-holding" states where lien holders maintain possession of vehicle titles until the underlying loans are paid in full. To prevent this unintended limitation, we would suggest that the Department adopt a narrow definition of "consumer credit" consistent with Section (i)(6) of the Act which excludes loans used to finance an automobile purchase, where the loan is secured by the automobile.

***(f) Penalties and remedies.***

The severity of the penalties provided by section (f) provides some indication of the significant risk lawmakers perceive as associated with certain types of credit offered to members of the armed forces. However, we note that, in imposing penalties such as imprisonment and rendering the contract void, the Act provides an enormous disincentive to make loans that are even potentially covered by its requirements. As a result, it is crucial that the implementing regulations provide lenders with clear certainty of who is covered, what loans or other advances are covered, and what is required by each party to a transaction.

***(g) Servicemembers civil relief act protections unaffected.***

No comment.

***(h) Regulations.***

No comment.

***(i) Definitions.***

(1) Covered Member. Particularly in light of the penalties imposed for violation of the Act that rest on the lender, we urge the Department to include a requirement in the regulation that applicants provide verification that they are either a covered member or a dependent of a covered member as part of the application process. Another option would be for the Department to establish and maintain a database, accessible to lenders, which would contain the names of eligible dependents. Further, we would suggest that lenders be permitted access to a database, such as the Department's Manpower Data Center, to verify whether a person is on active duty.

(2) Dependents. No comment.

(3) and (4) Interest and Annual Percentage Rate. Subsection (i)(3) defines "Interest" to include "all cost elements in association with the extension of credit, including fees, service charges, renewal charges, credit insurance premiums, any ancillary product sold with any extension of credit…and any other charge or premium with respect to the extension of consumer credit." Subsection (i)(4) defines "Annual percentage rate" as having the same meaning as in Section 107 of the Truth in Lending Act (15 U.S.C. Section 1606), as implemented by the FRB. The subsection (i)(4) definition continues and includes charges and fees for single premium credit insurance and other ancillary products sold in connection with the credit transaction in the calculation of the annual percentage rate. We note that both the interest and the annual percentage rate definitions conflict with the Truth in Lending Act and Regulation Z. Thus, to provide consistency, we would suggest that any implementing regulation exclude *voluntarily elected* credit insurance or ancillary products from the definitions of "Interest" and "Annual percentage rate" in Subsection (i)(3) and (4).

To illustrate, we note that the definition of "Annual percentage rate" in Subsection (i)(4) of the Act is inconsistent with 12 C.F.R. § 226.4(d)(1), even though the Act cites Section 107 of the Truth in Lending Act as its source for the definition.[3] In this section of Regulation Z, the FRB has stated that v*oluntarily elected* credit insurance premiums and other ancillary products purchased in connection with a credit transaction cannot be defined as "interest" or a "finance charge" because these types of premiums or fees are *not imposed directly or indirectly by the*

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[3] Section 107(a) of the Truth in Lending Act requires that the annual percentage rate be determined "in accordance with the regulations of the Board" and further describes the calculation methods for both closed end and open end credit transactions. Both the closed end and open end provisions of Section 107 reference that the annual percentage rate may be determined by a method prescribed by the Federal Reserve Board (Regulation Z) so long as the calculation is accurate within specific tolerances.

*creditor as an incident to or a condition of the extension of credit,* and do not fit within the definition of "Finance Charge" in 12 C.F.R. § 226.4(a).

In 12 C.F.R. § 226.4(a), the FRB defines "Finance Charge" as the cost of consumer credit as a dollar amount. It includes any charge payable directly or indirectly by the consumer *and imposed directly or indirectly by the creditor as an incident to or a condition of the extension of credit*. Twelve C.F.R. §§ 226.4(b), (c) and (d) go on to describe specific types of charges included within and excluded from the definition of finance charge. Twelve C.F.R. § 226.4(d)(1) specifically provides that *voluntary* credit insurance premiums paid for credit life, accident, health or loss-of-income insurance may be excluded from the finance charge under certain conditions:

- Coverage is not required by the creditor and this fact is disclosed;
- The premium or fee for coverage and the term of coverage is disclosed, if the term is less than the term of the credit transaction;
- The consumer signs or initials an affirmative request for the insurance after receiving disclosures;

Requiring that the cost of these types of voluntarily-purchased insurance coverage and products be included in the annual percentage rate calculation risks distorting the true cost of credit, risks confusing borrowers by overstating the amount of the finance charge, and conflicts with Regulation Z. We would submit that active duty servicemembers, perhaps assigned to a more dangerous tour of duty, may truly want to purchase additional insurance coverage, such as credit life or disability in connection with a nonpurchase money secured or unsecured traditional loan. However, although credit insurance premium rates are strictly regulated by state insurance departments, availability of these products could be limited or eliminated as an option for persons covered by the Act as a result of the 36% maximum rate cap.

We also note that, from an operational perspective, our systems have been programmed to compute finance charges and annual percentage rates in accordance with Regulation Z. Any change to these terms will thus require significant system enhancements and form changes. Thus, we would suggest that implementing regulations provide for a reasonable time period for creditors to come into compliance. We would submit that the alternative, to eliminate credit products offered to servicemembers while system enhancements are implemented, would not serve the interests of borrowers or creditors.

(5) Creditor. Because the Act risks unduly restricting a wide range of loan products, we urge that its coverage be narrowed to a creditor who extends so-called "pay day" or similar loans, as defined below.

(6) Consumer Credit. We would recommend that, in the implementing regulations, the Department narrow the definition of "consumer credit" to address "pay day" and similar loans so that military personnel and their dependents do not lose access to popular, convenient, and common credit products and terms. As discussed above, the definition as it currently appears in the Act risks limiting the availability of a wide range of loan products. Thus, we would suggest, at a minimum, that the Department clarify the term "residential mortgage" (which is excluded from the term "consumer credit") to specifically include traditional home equity loans and lines of credit, since they are also secured by residential real estate and give the military family much-needed flexibility in freeing up equity to live on or to use for repayment of other debt. Without this exclusion, this type of lending could be severely limited for servicemembers and their families. As noted above, we would also suggest excluding from the definition of "consumer credit" loans to purchase, or to refinance the purchase of, a vehicle, including those where the lender holds title to the automobile.

A broader method of limiting the application of the Act to pay-day lending would be to narrowly define consumer credit as follows:

"A loan with a term that does not exceed 120 days in which a creditor (a) accepts one or more checks dated on the date written and agrees to hold them for a period of days before deposit or presentment, or accepts one or more checks dated subsequent to the date written and agrees to hold them for deposit; (b) accepts one or more authorizations to debit a consumer's deposit account held by an unaffiliated financial institution; or (c) accepts an interest in a consumer's wages, including, but not limited to, a wage assignment."

The definition may further limit the category of loans covered by the Act by imposing a maximum dollar amount, since pay day loans are often issued in small amounts. By limiting the definition in this fashion in the regulation, the regulation can effectively eliminate many of the issues and problems identified by the comments we have noted in this letter.

We appreciate this opportunity to submit comments and support the Department's efforts to implement regulations on these issues. HSBC is committed to disclosing terms and conditions of all our products so that consumers can make informed choices about whether our products work for their personal financial situation. In addition, HSBC has a significant financial literacy education program that provides free consumer information via written materials, internet tools and workshops nationwide so consumers can learn more about financial topics important to them and their families to make informed choices going forward.

If you should have any questions or comments regarding this letter, please feel free to contact me.

Sincerely,